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STATE FOR SCA/CEN, EEB/ESC
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E.O. 12958: N/A

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SUBJECT: KAZAKHSTAN: FATE OF LARGEST BANKS TO BE DECIDED
IMMINENTLY (PART 1 OF 3)

11. (U) Sensitive but unclassified. Not for public Internet.

12. (U) This is the first in a three-part series analyzing recent developments in Kazakhstan's banking sector, the possible future liquidation of its assets, and potential implications for international export credit agencies.

13. (SBU) SUMMARY: U.S. Department of Treasury Advisor Tom Lanier and International Economist in the Office of Europe and Asia Larry Norton visited Almaty and Astana June 10-13 to assess current conditions and trends in Kazakhstan's economy and the overall health of its financial sector. Lanier and Norton's interlocutors reported that Kazakhstan's Financial Supervision Agency (FSA) has ordered the country's largest private banks - Alliance and BTA - to submit proposals for the restructuring of their foreign obligations to their international creditors. The fate of BTA and Alliance, according to the FSA, is entirely contingent upon the level of investor acceptance of the proposed restructuring. Should creditors reject the offers, the FSA will be forced to liquidate the banks' assets, with no promises of preferential treatment for predominantly western Export Credit Agencies (ECA). END SUMMARY.

THREE DEBT RESTRUCTURING OPTIONS

14. (SBU) Financial Supervision Agency (FSA) deputy head Kuat Kozhakhmetov told Lanier and Norton that both BTA and Alliance Banks are now seeking to restructure their external debt of around \$33 billion.

15. (SBU) According to the FSA, Alliance Bank will be the first to offer three possible options to its international creditors:

Option A - 20% immediate cash repayment at an 80% discount;
Option B - 50% repayment over seven years with 7% interest; and
Option C - 100% repayment over 15 years with 5% interest.

The response of international creditors to Alliance's offer is expected to serve as a litmus test for BTA's subsequent debt restructuring.

ALLIANCE UNDER THE MICROSCOPE

¶6. (SBU) According to the FSA's Kozhakhmetov, Alliance is in a more precarious position than BTA due to the poor quality of its assets and the increasing likelihood that the Kazakhstani government will not come to its rescue, should the debt restructuring plan fail. Kozhakhmetov said that there is currently a \$1.1 billion deficit in the Alliance Bank balance sheet, which is likely linked to the discovery of a \$1 billion contingent liability that had been secured by U.S. Treasury bonds. The Managing Director for International Relations at Alliance Bank, Gaziz Shakhanov, told Lanier and Norton that the bank's recent discovery of its "shockingly bad asset quality" was confirmed in a recent report to the FSA showing that the bank has a negative equity balance. According to Shakhanov, Alliance Bank is now operating under a "special regime" (i.e., the first stage of bankruptcy according to FSA regulations) but he remains guardedly optimistic that the bank may recoup its equity by either restructuring its debt, or by receiving a significant capital injection from the Samruk Kazyna National Welfare Fund. With the possibility that there may be other hidden liabilities, the goal is to determine the bottom line for Alliance. "We need to show the size of the hole," said Shakhanov.

BTA HOLDING ITS BREATH

¶7. (SBU) The First Deputy Chairman of the BTA Management Board, Galymzhan Pirmatov, told Lanier and Norton that the much anticipated KPMG audit of BTA has been completed, and the results were unofficially shared during a BTA conference call on June 4. At this point, said Pirmatov, BTA is awaiting official shareholder and FSA approval before going public with the final numbers. According

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to the CEO of ATF Bank Alexander Picker, the results are likely to show that BTA now has a negative equity of at least \$7 billion.

ASSET QUALITY IN CRITICAL CONDITION

¶8. (SBU) European Bank for Reconstruction and Development (EBRD) Senior Banker Tatyana Tyo said that she is "very concerned" about the declining asset quality and increasing percentages of non-performing loans (NPL) in loan portfolios. She added that many of the banks that have participated in the Kazakhstani government's anti-economic crisis program to provide relief to small and medium enterprises (SME) have simply dispersed the funds allocated by Samruk Kazyna by refinancing existing loans. As she sees it, funds designated for needed SME support to kick-start the economy are largely being used to adjust the terms of non-performing loans by refinancing them at a 1-2% discounted interest rate, and granting 6-12 month grace periods. In essence she said, this will only extend the loan period, but "they will eventually surface."

¶9. (SBU) The biggest risk for most Kazakhstani banks with non-performing loans in their portfolios remains their exposure to the real estate markets. Alliance's Shakhanov said that Alliance has "significant exposure to the real estate market, particularly for the construction of elite residential complexes." Describing the banking sector as a whole, Astana Finance Chairman of the Board Ketel Islamov said, "the situation overall is being described more optimistically than it is in reality." Astana Finance is heavily exposed to the "frozen" real estate market, Islamov said that he expects no increases or improvements in the value of its mortgage portfolio. He believes that government anti-crisis support for the market is largely inadequate and has only allowed for the refinancing of existing loans.

CREDITORS MAKE THE CALL

¶10. (SBU) According to the FSA, Kazakhstan's banks have little time to develop detailed plans for debt restructuring (which must be acceptable to their international creditors) and present them to the Kazakhstani financial authorities. The FSA's Kozhakhmetov said Alliance must complete its restructuring by July 15, and BTA by August 1. He believes that by offering several options, different types of investors/creditors will find one of the three options

acceptable. However, if the debt restructuring is not accepted by creditors, then the next phase will be to place the bank into a conservatorship and move forward with the liquidation of assets. The work of the court appointed liquidator "ideally would go quickly, because I understand that the faster you liquidate, the more value you recover" said Kozhakhmetov.

ALLIANCE REPORTS MOU WITH CREDITORS

¶11. (SBU) In a recent positive development, Alliance Bank reported in a press release dated July 8 that it had signed a Memorandum of Understanding with the committee of creditors, which includes the Asian Development Bank, HSBC Bank, and Wachovia Bank to name a few.

According to the agreement, Alliance Bank expects to offer a cash payout of as much as \$500 million to some of its creditors, in return for their acceptance of a 77.5 percent haircut. While details regarding the specific creditors and exact timeline have not been fully specified, it is apparent that Alliance Bank stands to retire \$1.85 billion in debt as a result. The restructuring plan will be sent for official review by the FSA on July 15.

PRIORITIES IN REPAYMENT UNDER LIQUIDATION

¶12. (SBU) Should it come to liquidation for either or both Alliance and BTA, FSA Control Department Director Mukhtar Bubeyev, says liquidated assets will be used, in priority order, to pay: a) salaries; b) fines; c) individuals with deposits under \$5 million; d) individuals with deposits over \$5 million; and e) corporate deposits. According to Bubeyev, the current intention of the FSA is to treat all trade finance the same as any other international

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creditor. As for groups like EBRD, "personally, I think they should be put at the very bottom of the list because they are a development bank" he said.

¶13. (SBU) According to FSA Deputy Chairman Kozhakhmetov, despite the fact that the Government of Kazakhstan has put \$1.8 billion in equity, and \$2.2 billion in deposits into the banking sector to date, it would "stand in line with everyone" in the event of liquidation. This point was corroborated by the FSA's Bubeyev, who said that even if the National Bank of Kazakhstan (NBK) has given funds to a bank which fails, it will not be the first creditor in line for repayment, but rather would be grouped with other creditors.

PREFERENTIAL TREATMENT FOR EXPORT CREDIT AGENCIES?

¶14. (SBU) EBRD Senior Banker Tatyana Tyo claimed that there will be no special treatment for export credit agencies (ECAs), despite reports that the WTO has reportedly sent letters to Samruk-Kazyna specifically describing the long-term credit risk to Kazakhstan of not offering preferential conditions. "We want to treat everyone equally. If we do give preferential treatment to BTA's \$3.5 billion in trade finance, it will cause more pain to the creditors," said BTA First Deputy Chairman Pirmatov. However, Pirmatov acknowledged that this may depend on the Kazakhstani government's strategic priorities, for example, the future importation of critical industrial equipment.

¶15. (SBU) Several Kazakhstani bank representatives agreed that the situation may become problematic if export credit agencies (ECAs) are not given preferential treatment. "It will create a risk to the system if the export banks are treated the same as other creditors" said KazKommertsBank Executive Director Sergey Mokrousov. Option Three, he believes, may have been specifically designed for such Western agencies.

¶16. (SBU) Samruk Kazyna Managing Director Abay Iskanderov delivered a slightly different message to Lanier and Norton that distanced the government from the plight of the banks, while still trying to reassure ECAs that they would likely be offered beneficial terms. "When it comes to the ECAs, everyone knows who you are messing with. There will probably be no haircut to the ECAs, but very likely the repayment timeline will be extended. However, it will be the government's decision whether or not to treat the ECAs differently."

Further elaborating Samruk-Kazyna's position, he said "the

government is not a historic partner to BTA and the other banks, and most of the negotiation now will have to be between the banks and the creditors." Iskanderov explained that the decisions by Samruk-Kazyna regarding the banks had been made in close consultation with the National Bank, the FSA, the Ministry of Finance, and the Prime Minister's office, and said, "It is clear now that the government will not supply all the capital needed." With \$18 billion in outstanding loans, including \$11.5 billion in non-performing loans, the government cannot be expected to assume all of these liabilities, he concluded.

¶17. (SBU) According to the EBRD, some large depositors (over \$5 million) are already reporting difficulties in retrieving assets from both BTA and Alliance. For smaller depositors, EBRD also says it is highly unlikely that the Kazakhstani Deposit Insurance Scheme would realistically be able to repay them in the event of liquidation. Tyo cited as an example the continued failure of the Deposit Insurance Scheme to repay in full customers of Valut Transit Bank, which was liquidated by the FSA starting in December 2007. (NOTE: According to the Chairwoman of the Deposit Insurance Fund, 96% of all depositors with guaranteed deposits less than or equal to 700,000 tenge -- approximately \$4670 -- were repaid in full by December 2008. END NOTE.)

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